No. 80-264

In the Supreme Court of the United States

OCTOBER TERM, 1980

ELMER B. STAATS, COMPTROLLER GENERAL OF THE UNITED STATES,

AND

UNITED STATES OF AMERICA, PETITIONERS

v.

BRISTOL LABORATORIES DIVISION OF BRISTOL-MYERS COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE PETITIONERS

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QUESTION PRESENTED

Whether, with respect to negotiated government contracts, the Comptroller General is authorized by law to examine the contractor's books and records pertaining to costs of research and development, advertising and promotion, distribution, and administration, where such costs, although not allocated by the contractor to particular products or calculated on a product basis in determining price, are defrayed by the contractor from commingled general revenues that include the government's payments under the contracts.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-4a) is reported at 620 F.2d 17. The opinion of the district court (Pet. App. 5a-12a) is reported at 428 F. Supp. 1388.

JURISDICTION

The judgment of the court of appeals was entered on March 25, 1980 (Pet. App. 13a-14a). On June 12, 1980, Mr. Justice Marshall extended the time for filing a petition for a writ of certiorari to and including August 22, 1980. The petition for a writ of certiorari was filed on August 21, 1980, and was granted on December 8, 1980 (J.A. 154). The jurisdiction of this Court rests upon 28 U.S.C. 1254(1).

STATUTES INVOLVED

1. 10 U.S.C. 2313(b) provides:

> Except as provided in subsection (c), each contract negotiated under this chapter shall provide that the Comptroller General and his representatives are entitled, until the expiration of three years after final payment, to examine any books, documents, papers, or records of the contractor, or any of his subcontractors, that directly pertain to, and involve transactions relating to, the contract or subcontract.

2. 41 U.S.C. 254(c) provides:

> All contracts negotiated without advertising pursuant to authority contained in this Act shall include a clause to the effect that the Comptroller General of the United States or any of his duly authorized representatives shall until the expira-

tion of three years after final payment have access to and the right to examine any directly pertinent books, documents, papers, and records of the contractor or any of his subcontractors engaged in the performance of and involving transactions related to such contracts or subcontracts. Under regulations to be prescribed by the Administrator, however, such clause may be omitted from contracts with foreign contractors or foreign subcontractors if the agency head determines, with the concurrence of the Comptroller General of the United States or his designee, that the omission will serve the best interests of the United States. However, the concurrence of the Comptroller General of the United States or his designee is not required for the omission of such clause—

(1) where the contractor or subcontractor is a foreign government or agency thereof or is precluded by the laws of the country involved from making its books, documents, papers, or records available for examination; and

(2) where the agency head determines, after taking into account the price and availability of the property or services from United States sources, that the public interest would be best served by the omission of the clause.

If the clause is omitted based on a determination under clause (2) a written report shall be furnished to the Congress. The power of the agency head to make the determination specified in the preceding sentences shall not be delegable.

STATEMENT

1. In 1973 and 1974, respondent Bristol Laboratories entered into three contracts with the Defense Supply Agency of the Department of Defense and one contract with the Veterans Administration for the sale of pharmaceutical products to the government. All four were negotiated fixed-price contracts, with a total price of approximately $2 million (Pet. App. 6a-7a; J.A. 88-93).[1] As required by 10 U.S.C.

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[1] A negotiated government contract is a method of procurement authorized by statute to be used in situations in which the formal public advertising and bidding procedure is deemed impractical or unnecessary. See 10 U.S.C. 2304(a); 41 U.S.C. 252(c). Respondent's VA contract was executed (J.A. 29, 89) pursuant to 41 U.S.C. 252(c)(10), which authorizes contracts to be negotiated without formal advertising "if * * * for property or services for which it is impracticable to secure competition"; each of respondent's contracts with the Defense Supply Agency was executed (J.A. 29-30, 90-91) under 10 U.S.C. 2304(a)(7), which provides that a contract may be negotiated without formal advertising "if * * * the purchase or contract is for medicine or medical supplies." For a general discussion of negotiated and fixed-price contracts, see, *e.g.*, I R. Nash & J. Cibinic, *Federal Procurement Law* 317-321, 412-415 (3d ed. 1977).

Negotiated contracts comprise approximately 90% of the total amount expended by the government for procurement. See I R. Nash & J. Cibinic, *supra*, at 317; see also F. Mosher, *The GAO: The Quest for Accountability in American Government* 318 (1979). In fiscal year 1979, the aggregate value of negotiated government contracts was approximately $78 billion. See Office of the Secretary of Defense, *Military Prime Contract Awards for Fiscal Year 1979*, Table 9 (1979); General Services Administration, *Procurement by Civilian Executive Agencies for Fiscal Year 1979*, Part I (1979).

2313(b)[2] and 41 U.S.C. 254(c),[3] each of the contracts contained a standard access-to-records provision in which respondent agreed that "the Comptroller General of the United States or any of his duly authorized representatives shall, until the expiration of three years after final payment under this contract * * *, have access to and the right to examine any directly pertinent books, documents, papers, and records of the Contractor involving transactions related to this contract" (Pet. App. 6a-7a; J.A. 89-93).

Pursuant to these statutory and contractual provisions, the Comptroller General, by letter of August 26, 1974, made a timely request to respondent for access to

> all books, documents, papers and other records directly pertinent to the contracts, which include, but are not limited to (1) records of experienced costs including costs of direct materials, direct labor, overhead, and other pertinent corporate costs, (2) support for prices charged to the Government, and (3) such other information as may be necessary for us to review the reasonableness of the contract prices and the adequacy of the protection afforded the Government's interests.

Pet. App. 7a-8a; J.A. 57-59. The Comptroller General explained that "because of the increasing Federal involvement in the procurement of pharmaceuticals, the General Accounting Office has underway a review

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[2] This provision is applicable to the Defense Supply Agency contracts.

[3] This provision is applicable to the Veterans Administration contract.

of the procurement of drugs by agencies of the Federal Government" and that the requested records were "necessary to conduct such a review" (J.A. 57).[4]

In reply, respondent offered to make available "(1) Bristol's contract files which included shipment and invoice records, (2) records and data relating to manufacturing costs assigned by the firm to the products purchased under the contracts, and (3) Bristol's product prices to its non-Federal customers" (J.A. 68). However, respondent declined to produce "records concerning costs incurred for activities such as research and development, marketing and promotion, distribution and administration * * * [because] such costs are not assigned to individual products and records concerning these costs are not pertinent to the cited contracts" (J.A. 69). Respondent also refused to provide "records relating to the methodology and decisions involved in the firm's establishment of prices for the products purchased under the contracts" (*ibid.*). By letter dated March 6, 1975, the Comptroller General advised respondent that its proposal failed to satisfy the legal requirements under which the GAO request had been made (J.A. 68-69).

2. On March 18, 1975, respondent commenced the present action in the United States District Court for the Southern District of New York seeking declaratory and injunctive relief against the Comp-

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[4] In an attachment to this letter, the Comptroller General further stated that "the clear intent of the statute was to provide for the examination by our Office of such of the contractor's records as would permit a valid evaluation of the reasonableness of the prices charged" (J.A. 63).

troller General (J.A. 11-13). The United States later intervened as a defendant and filed a counterclaim to gain access to the records requested by the Comptroller General (J.A. 27-34).

Respondent conceded in the district court that it was obligated "to provide access to records of its manufacturing costs, records which relate to the pricing of the products delivered and records required to verify all data obtained during the course of the review" (Pet. App. 8a). On this basis, it agreed to allow inspection of records pertaining to "the following items, which it lists as factors taken into account in setting prices to the government: manufacturing costs (including raw and packaging materials, labor and fringe benefits, quality control and supervision); manufacturing overhead (including plant administration, production planning, warehousing, utilities and security); royalty expenses; and delivery costs" (*ibid.*). However, respondent "strenuously resist[ed] producing data with respect to research and development, marketing and promotion, distribution and administration * * *" on the ground that these costs, which respondent neither allocated to particular products or contracts nor considered in setting the price charged to the government, "are too remote to the contracts and have only the most general relation, if any, to the prices charged" (*id.* at 8a-9a).

Following discovery, the district court granted respondent's motion for summary judgment and denied the cross-motion of the government (Pet. App. 5a-12a).[5] The court rejected the government's argu-

[5] The parties' initial motions for summary judgment were denied because of uncertainties concerning respondent's accounting methods (Pet. App. 6a n.1; J.A. 6-10). These cross-motions were renewed after completion of the necessary discovery.

ment that, with respect to respondent's unallocated costs, the access-to-records provision authorized examination of "all costs met in whole or in part from revenues earned on the federal contracts * * *" (Pet. App. 9a). Since respondent's unallocated costs "are pooled and met out of gross revenues * * * [consisting of] revenues from government contracts * * * com[m]ingled with revenues from non-government contracts," the court expressed its concern that the position urged by the government would mean that "there are no excludable records" and that respondent would be required "to make available virtually all of its books and records * * * because * * * government dollars * * * contribute to the fund from which all of the company's expenses are paid" (*id.* at 9a-10a). The court concluded that such a result would be "inconsistent" with the "words of limitation" in the access-to-records provisions authorizing the Comptroller General to examine " 'directly pertinent * * * records * * * involving transactions related to [the] contract' " (*id.* at 10a; emphasis omitted). In the court's view, the "reasonable assumption is that if Congress had wished to condition the receipt of a fixed-price negotiated contract on the contractor's agreement to allow such unusual and unfettered government inspection of their business records, it would have done so explicitly" (*ibid.*). In addition, the court held as a matter of contract law that "[t]he government's position is particularly unrealistic" because, in construing "the intent and understanding of the parties * * *, [i]t is inconceivable that [respondent], or any contracting firm, could have understood this clause to authorize the sweeping power of inspection claimed by the GAO" (*id.* at 10a-11a). Accordingly, the court sustained respondent's posi-

tion as "a responsible and reasonable effort to distinguish 'directly pertinent' matter within the meaning of the access to records clause. It represents a sensible point at which to draw the line" (*id.* at 12a).

3. On the government's appeal, the court of appeals affirmed in a per curiam opinion for the reasons given by the district court (Pet. App. 1a-4a).[6] The court of appeals also noted that two intervening decisions of the Seventh Circuit had "reject[ed] the holding of the court below," but it did "not find their reasoning persuasive" (*id.* at 3a). See *Eli Lilly & Co.* v. *Staats*, 574 F.2d 904 (7th Cir.), cert. denied, 439 U.S. 959 (1978); *United States* v. *Abbott Laboratories*, 597 F.2d 672 (7th Cir. 1979).

SUMMARY OF ARGUMENT

The General Accounting Office is charged by Congress with the responsibility to "investigate * * * all matters relating to the receipt, disbursement, and application of public funds * * * [and to] make recommendations looking to greater economy or efficiency in public expenditures." 31 U.S.C. 53(a). Pursuant to 10 U.S.C. 2313(b) and 41 U.S.C. 254(c), the Comptroller General is entitled to have access to, and to examine, the books and records of a government contractor that are directly pertinent to the contract and involve transactions relating thereto. Respondent acknowledges that the access-to-records provisions au-

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[6] After both parties had initially appealed, the court of appeals remanded the case for consideration of respondent's request for a protective order. Upon the consent of the parties, the district court approved a protective order on September 6, 1979 (Pet. App. 3a n.2; J.A. 151-153). Thereafter, only the government pursued its appeal. Our petition in this case raises no issue concerning the need for or scope of an appropriate protective order.

thorize the Comptroller General to inspect certain of its cost records, but it contends that the Comptroller General is not empowered to examine its records pertaining to unallocated costs of research and development, advertising and promotion, distribution, and administration. This contention is contrary both to the purpose and legislative history of the access-to-records statutes and to GAO's consistent and long-standing interpretation that Congress has not disapproved.

Sections 2313(b) and 254(c) are premised on Congress' determination that "negotiated contracts * * * require close supervision and control * * *." H.R. Rep. No. 791, 82d Cong., 1st Sess. 2 (1951). Representative Hardy, the sponsor of the legislation and chairman of the subcommittee that considered the bill, explained that examination of contractors' records by the Comptroller General would allow "the General Accounting Office to look behind the * * * [price] which had been established * * * [to assess whether it was] excessive" and would act as a "safeguard against waste and extravagance" in government procurement. 97 Cong. Rec. 13198 (1951). Because of its concern that "there is every chance in the world that the Government will come out on the short end of the deal," Congress enacted the access-to-records statutes to "enable the * * * [Comptroller General] to check the transaction, both from the Government records and the contractors' books" (*ibid.*) (remarks of Rep. Hardy). And, in light of GAO's responsibility to investigate and make recommendations regarding economy and efficiency in public expenditures, Congress intended that "the Comptroller General [be given] the proper tools to do the job the Congress has instructed him to do" and that, "if * * * [GAO] should find that the * * * [price

was] excessive, it could, and undoubtedly would, bring the facts to the attention of the contracting officer, and possibly in an extreme case, it might call attention of the Congress to the situation" (*ibid.*) (remarks of Rep. Hardy).

Moreover, GAO has consistently construed the access-to-records statutes to authorize examination of all cost records relating to the reasonableness of the contract price. On several occasions GAO has presented this interpretation to Congress, which has never indicated its disapproval.

The court of appeals, in sustaining respondent's position, ignored the purpose and legislative history of the access statutes and rejected this longstanding and consistent administrative construction. But as this Court has observed, the "objective * * * [in construing a statute] is to ascertain the congressional intent and give effect to the legislative will." *Philbrook* v. *Glodgett*, 421 U.S. 707, 713 (1975). Furthermore, it is a " 'venerable principle that the construction of a statute by those charged with its execution should be followed unless there are compelling indications that it is wrong * * *.' " *E. I. du Pont de Nemours & Co.* v. *Collins*, 432 U.S. 46, 54-55 (1977), quoting *Red Lion Broadcasting Co.* v. *FCC*, 395 U.S. 367, 381 (1969). And judicial deference to the agency's construction is especially appropriate where, as in this case, that "construction has been 'fully brought to the attention of the public and the Congress,' and the latter has not sought to alter that interpretation * * *." *United States* v. *Rutherford*, 442 U.S. 544, 554 n.10 (1979), quoting *Apex Hosiery Co.* v. *Leader*, 310 U.S. 469, 489 (1940).

In light of the language, legislative history, and evident purpose of the access-to-records provisions, the Comptroller General must be allowed to examine

all of the contractor's cost records that are necessary and appropriate to determine whether the price charged the government was "extravagan[t]," "excessive," or "wasteful[]." 97 Cong. Rec. 13198 (1951) (remarks of Rep. Hardy). Applying this standard to the present case, it is clear that the Comptroller General is entitled to access to respondent's cost records pertaining to research and development, advertising and promotion, distribution, and administration.

The court below denied access by GAO because the records in question involve costs that respondent neither allocates to particular products or contracts nor calculates on a product basis in setting prices. But the government cannot be bound by the accounting method respondent has established for its own purposes. If respondent had fully allocated its costs, GAO's right to conduct an inspection adequate to evaluate the reasonableness of the contract price would be clear, and no different outcome is warranted simply because respondent has chosen to allocate only some of its costs.

Respondent's election to keep its business records on the basis of unallocated costs cannot obscure the fact that an examination of those costs is necessary for the Comptroller General to fulfill his statutory function of determining whether the government has been charged a reasonable price. To operate profitably, respondent must recover its costs from sales revenues, and it uses the payments by the government under the contracts at issue, as part of commingled general revenues, to help defray its unallocated expenses. Accordingly, respondent's unallocated costs are critical to an assessment of the fairness of the contract price and the advisability of continued adherence by the government to the negotiated procurement methods employed here. Es-

pecially where, as in the pharmaceutical industry, direct manufacturing and delivery costs constitute only about 9% of a product's sale price, and manufacturers expend approximately 12% of sales revenues on research and development, it would completely frustrate GAO's inquiry into the appropriateness of the contract price to limit its examination to allocated costs such as production and delivery and to exclude such significant unallocated costs as research and development, advertising and promotion, distribution, and administration.

ARGUMENT

THE ACCESS-TO-RECORDS PROVISIONS AUTHORIZE THE COMPTROLLER GENERAL TO EXAMINE A CONTRACTOR'S BOOKS AND RECORDS PERTAINING TO UNALLOCATED COSTS DEFRAYED FROM COMMINGLED GENERAL REVENUES THAT INCLUDE THE GOVERNMENT'S PAYMENTS UNDER THE CONTRACT

A. Introduction

The General Accounting Office was established by the Budget and Accounting Act of 1921, ch. 18, Title III, Section 301, 42 Stat. 23, 31 U.S.C. 41. The GAO is "independent of the executive departments and under the control and direction of the Comptroller General of the United States" (31 U.S.C. 41), who is "appointed by the President with the advice and consent of the Senate" (31 U.S.C. 42) and serves for a term of 15 years subject to removal for cause "at any time by joint resolution of Congress" (31 U.S.C. 43). See also 5 U.S.C. 902; 31 U.S.C. 65(d). Thus, the GAO is "an independent agency within the legislative branch of the Government." I R. Nash & J. Cibinic, *Federal Procurement Law* 19 (3d ed. 1977). See also Cibinic &

Lasken, *The Comptroller General and Government Contracts*, 38 Geo. Wash. L. Rev. 349, 349 & nn.2, 3 (1970).

Among other duties, the Comptroller General "shall investigate * * * all matters relating to the receipt, disbursement, and application of public funds" and "shall make recommendations [to Congress] looking to greater economy or efficiency in public expenditures" (31 U.S.C. 53(a)). In addition, "[t]he Comptroller General is authorized and directed to make an expenditure analysis of each agency in the executive branch of the Government * * * which * * * will enable Congress to determine whether public funds have been economically and efficiently administered and expended" (31 U.S.C. 60). See also 31 U.S.C. 65(a) ("[t]he accounting of the Government [shall] provide * * * effective control over income, expenditures, funds, property, and other assets").

The access-to-records provisions at issue in this case—10 U.S.C. 2313(b) and 41 U.S.C. 254(c)—complement the foregoing statutes and specifically contemplate GAO review of contractors' books and records. See Cibinic & Lasken, *supra*, 38 Geo. Wash. L. Rev. at 388. By the express terms of Sections 2313(b) and 254(c), all government contracts negotiated pursuant to designated statutory authority must provide that the Comptroller General shall have access to, and be entitled to examine, the books and records of the contractor that are directly pertinent to the contract and involve transactions relating thereto. Respondent acknowledges that it is obligated to allow the Comptroller General to inspect certain of its cost records. See Pet. App. 8a; Br. in Opp. 4 n.9. See also *United States* v. *Abbott Laboratories*, 597 F.2d 672 (7th Cir. 1979); *Eli Lilly & Co.* v. *Staats*, 574 F.2d 904, 912-916 (7th Cir.), cert. denied, 439

U.S. 959 (1978); *Hewlett-Packard Co.* v. *United States*, 385 F.2d 1013, 1016 (9th Cir. 1967), cert. denied, 390 U.S. 988 (1968); *SmithKline Corp.* v. *Staats*, 483 F. Supp. 712, 722 (E.D. Pa. 1980), appeal pending, No. 80-1464 (3d Cir., filed Mar. 19, 1980), conditional petition for cert. before judgment denied, No. 80-434 (Dec. 8, 1980);[7] *Merck & Co.* v. *Staats*, Civ. Action No. 74-1447 (D.D.C. Aug. 12, 1977), slip op. 3-4, appeals pending, Nos. 79-1435, 79-1438 (D.C. Cir., argued Feb. 11, 1980), conditional petition for cert. before judgment denied, No. 80-416 (Dec. 8, 1980).[8]

Respondent contends, however, that the access-to-records provisions do not extend to records pertaining to its unallocated costs of research and development, advertising and promotion, distribution, and administration, despite the fact that these costs are defrayed from total revenues that include the government's payments under the contracts. In sustaining respondent's position, the court of appeals failed to consider the purpose and legislative history of the statutory provisions and to defer to GAO's longstanding and consistent interpretation that has been recognized and left undisturbed by Congress. Contrary to the court of appeals' decision, respondent's construction is inconsistent with the statutes and, if adopted by this Court, would severely hinder the Comptroller General's authority to promote sound government

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[7] Oral argument in *SmithKline* is currently scheduled for February 23, 1981. A motion of SmithKline, consented to by the government, to postpone the argument pending this Court's disposition of the instant case is pending before the Third Circuit.

[8] By order filed December 17, 1980, the District of Columbia Circuit, acting on its own motion, deferred decision in *Merck* pending a decision by this Court in the present case.

procurement practices. Indeed, in this case, because unallocated costs represent the predominant part of the price of pharmaceuticals sold to the government, the decision below would render meaningless the Comptroller General's right of access and would totally defeat his statutory responsibility to evaluate the fairness of the contract price.

B. GAO's Interpretation Is Consistent With The Legislative History Of The Access-To-Records Statutes And Furthers The Congressional Purpose

Contrary to the decision below, the legislative history of the access-to-records statutes makes clear that Congress intended the Comptroller General to have a broad right of access in order to determine the reasonableness of the contract price and the adequacy of the protection afforded the government in negotiated procurements. The access statutes were enacted in 1951 as amendments to the Armed Services Procurement Act of 1947, ch. 65, 62 Stat. 21 *et seq.*, and the Federal Property and Administrative Services Act of 1949, ch. 288, 63 Stat. 377 *et seq.* See Act of Oct. 31, 1951, ch. 652, 65 Stat. 700.[9] The Committee Reports expressed Congress' determination that "negotiated contracts * * * require close supervision and control * * *." H.R. Rep. No. 791, 82d Cong., 1st Sess. 2 (1951); S. Rep. No. 603, 82d Cong., 1st Sess. 2 (1951). Representative Hardy, the sponsor of the legislation and chairman of the subcommittee that

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[9] As originally enacted, the two statutory provisions were identical. Although the language of 10 U.S.C. 2313(b) was slightly altered in a subsequent recodification, no change of substance was intended. See Act of Aug. 10, 1956, ch. 1041, Section 49(a), 70A Stat. 640; 102 Cong. Rec. 13952 (1956) (statement of Sen. O'Mahoney).

considered the bill, explained that examination of contractors' records by the Comptroller General would enable "the General Accounting Office to look behind the * * * [price] which had been established * * * [to assess whether it was] excessive" and would act as a "safeguard against waste and extravagance" in government procurement. 97 Cong. Rec. 13198 (1951). See also *id.* at 13373 (remarks of Rep. Hoffman) ("GAO is * * * the most effective agency we have against fraud and extravagance and waste and all those things"); (*ibid.*) (remarks of Rep. Church) (legislation "is necessary in the interest of integrity or economy"). As Representative Hardy emphasized:

> The major purposes of the bill are twofold: One, to give the Comptroller General the proper tools to do the job the Congress has instructed him to do; and, two, to provide a deterrent to improprieties and wastefulness in the negotiation of contracts.

Id. at 13198; see also *id.* at 13200 (remarks of Rep. Hardy).

In enacting the access-to-records statutes, Congress "clearly understood * * * that there are a lot of other situations besides those involving fraud which might be uncovered." 97 Cong. Rec. 13199 (1951) (remarks of Rep. Hardy). Because of its concern that, "aside from any intentional liberality on the part of the Government contracting officer, there is every chance in the world that the Government will come out on the short end of the deal," Congress sought to "enable the * * * [Comptroller General] to check the transaction, both from the Government records and the contractors' books (*id.* at 13198) (remarks of Rep. Hardy). See also *id.* at 13377 (remarks of Rep. Hoffman and Rep. Hardy). And, in accordance with

the Comptroller General's responsibility to investigate and make recommendations regarding economy and efficiency in public expenditures (see page 13, *supra*), Congress fully expected that "if * * * [GAO] should find that the * * * [price was] excessive, it could, and undoubtedly would, bring the facts to the attention of the contracting officer, and possibly in an extreme case, it might call attention of the Congress to the situation" (*id.* at 13198 (remarks of Rep. Hardy)). See also H.R. Rep. No. 791, *supra*, at 5 (GAO letter stating that "any abuses discovered by the General Accounting Office in exercising the authority contained [in the bill] promptly will be brought to the attention of the proper officials, and, if warranted, to the attention of the Congress"); S. Rep. No. 603, *supra*, at 4 (same).[10]

In passing this legislation, Congress also was well aware of the broad authority it was conferring upon the Comptroller General. For example, Representative Hoffman stated that "[t]he GAO under this bill can go into the books * * * and get * * * anything and everything they want * * *" (97 Cong. Rec. 13373 (1951)). Similarly, Representative Harvey noted that a contractor "would be subject to having all of his books opened up for inspection by Government officials" (*id.* at 13372). Indeed, in introducing an amendment to exempt certain suppliers of materials, Representative Harvey objected to the expansive terms of the Hardy bill (*id.* at 13376):

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[10] Respondent concedes (Br. in Opp. 9) that the purpose of the statutes "was to empower the Comptroller General to audit governmental contracts' costs and performance to the end that the government be guarded against excessive cost or waste."

> Some little contractor or manufacturer who may be using only 10 percent of his capacity for the production of goods for the prime contractor, but because of that—and he cannot afford to keep a separate set of books for that 10 percent—it means that every section of his books will have to come under the complete scrutiny of the GAO. He is going to be harassed no end to try to break down production costs and show the details on that 10 percent of his production that went into the general program of defense. While I credit the author of the bill with the very best of intentions, I do not think he understands or fully appreciates what the ultimate effect will be upon our economy if every person who is manufacturing anything is going to have to supply all the answers to the GAO on everything that he manufactures, and such is literally going to be the impact of the bill if this amendment is not included.

Representative Hill reiterated this concern, arguing that GAO could "come out to that little town and examine all of his books because he happens to be making a few pieces of equipment for a subcontractor in New York City" (*ibid.*). Representative Hoffman also supported adoption of the amendment because "[i]f someone out in the country makes a contract for * * * an item which may be 10 percent of the total production, * * * under this bill, if it goes through [without the amendment], the GAO can send someone out there and go through the books, not only with reference to that one item of 10 percent which went into production for the government, but into all of his other business where that same item was used" (*id.* at 13377). However, Representative Hardy opposed the amendment on the ground that it "would make it impossible frequently to obtain information which would be vital in a study of a contract" (*id.*

at 13376), and the Harvey amendment was defeated (*id.* at 13377).

We recognize that Representative Hardy's bill did not originally contain the provision that records examined by GAO be "directly" pertinent to a government contract. The word "directly" was added as a floor amendment offered by Representative Hoffman, who explained that "[t]he purpose is to limit the 'snooping' that may be carried on under this bill * * *." 97 Cong. Rec. 13377 (1951). But Representative Hardy did not object to this modification, which passed without debate or discussion (*ibid.*). In these circumstances, and especially given Representative Hardy's earlier opposition to the Harvey amendment and his belief that "those with nothing to hide have nothing to fear by opening their books to the General Accounting Office" (*id.* at 13197), it is unreasonable to conclude that Representative Hoffman's amendment significantly altered the scope or intendment of the Hardy bill or was intended to bar the Comptroller General's access to records legitimately needed, as in this case, to protect against waste, excessive prices, and ineffective procurement. See *Eli Lilly & Co.* v. *Staats*, *supra*, 574 F.2d at 916 & n.8. See also Comment, *The Comptroller General's Authority to Examine the Private Business Records of Government Contractors: Eli Lilly & Co.* v. *Staats*, 92 Harv. L. Rev. 1148, 1157-1158 (1979) ("[t]he court [in *Eli Lilly*] correctly rejected Lilly's argument that the insertion of the word 'directly' into the 'directly pertinent' formula sharply narrowed the scope of inquiry to be allowed the GAO").

Prior to the decision in this case, the courts of appeals had broadly construed the access-to-records provisions to effectuate the congressional intent to enable

GAO to detect government inefficiency or wastefulness and to recommend improvements in the system of negotiated contracts. As the Ninth Circuit explained in *Hewlett-Packard Co.* v. *United States*, *supra*, the Comptroller General is empowered to investigate whether a contractor's costs are "out of line with the contract price" and hence whether "the contract may have been an inappropriate means of meeting this particular procurement need of the Government. While this appraisal could not affect these particular contracts, it could lead to the use of other methods of meeting future procurement needs" (385 F.2d at 1016).[11] Similarly, in *Eli Lilly & Co.* v. *Staats*, *supra*, the Seventh Circuit followed "the broad reading of *Hewlett-Packard* * * * [as] most consistent with the plain meaning of the statutory language and with the legislative history" (574 F.2d at 913), and concluded that Congress envisioned "an inquiry [by the Comptroller General] into whether costs are excessive" (*id.* at 915).[12]

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[11] In *Hewlett-Packard*, GAO "requested all books, documents, papers or records * * * 'relating to the pricing and cost of performance, support for prices charged to the Government, and such other necessary information which would permit * * * [GAO] to review the reasonableness of the contract prices * * *'" (385 F.2d at 1015). The district court granted the government's motion for summary judgment "and entered a judgment substantially as prayed for in the complaint" (385 F.2d at 1013-1014), declaring that GAO "could examine any such records 'relating to the cost of producing the items furnished by Hewlett-Packard Company under the aforesaid contracts, including costs of direct material, direct labor and overhead costs * * *'" (385 F.2d at 1016). The court of appeals affirmed.

[12] The Seventh Circuit's analysis of the congressional purpose underlying the access-to-records statutes is discussed with approval in Comment, *supra*, 92 Harv. L. Rev. at 1157-1158 & nn.67-68.

Commentators have likewise recognized the broad remedial purpose of the access-to-records provisions. As Professor Mosher explained:

> The GAO audits a very limited sample of contracts annually, primarily to identify and evaluate the efficiency and effectiveness of procurement policy, pricing, controls, and auditing. Its focus is not upon individual contracts or contractors but upon the effectiveness of the systems and criteria whereby contracts are negotiated, carried out, and audited by the executive agencies. Its aims are primarily to develop and make recommendations for improvements in the process, not to seek out individual culprits.

See F. Mosher, *The GAO: The Quest for Accountability in American Government* 318 (1979). See also, *e.g.*, G. Cuneo, *Government Contracts Handbook* 183 (3d printing 1964) ("GAO audits are basically a post-performance audit review, and are related to the responsibilities of the Comptroller General to keep Congress informed of the degree of efficiency with which the executive agencies perform their procurement functions involving the administration of appropriated funds"); I R. Nash & J. Cibinic, *supra*, at 381 ("[i]n negotiated contracts, Congress has been continually concerned with the possibility that unreasonable prices will be paid"); Cibinic & Lasken, *supra*, 38 Geo. Wash. L. Rev. at 388 ("[n]ot to be overlooked is Congress' deep and abiding distrust of the negotiation process"). Furthermore, "[s]uch reports [by GAO to Congress based on the access-to-records provisions] can be very useful. They can and have sharpened the Government's negotiation practices." *Id.* at 389. See also J.A. 100.

As this Court has observed, the "objective * * * [in construing a statute] is to ascertain the congressional

intent and give effect to the legislative will." *Philbrook* v. *Glodgett*, 421 U.S. 707, 713 (1975). See also, *e.g.*, *United States* v. *American Trucking Associations*, 310 U.S. 534, 542 (1940) ("[i]n the interpretation of statutes, the function of the courts is * * * to give effect to the intent of Congress"). And, of course, a court's "individual appraisal of the wisdom or unwisdom of a particular course consciously selected by the Congress is to be put aside in the process of interpreting a statute. Once the meaning of an enactment is discerned * * * the judicial process comes to an end." *Rubin* v. *United States*, No. 79-1013 (Jan. 21, 1981), slip op. 7 n.8, quoting *TVA* v. *Hill*, 437 U.S. 153, 194 (1978). See also, *e.g.*, *Commissioner* v. *Bilder*, 369 U.S. 499, 504 n.5 (1962) ("the equitable considerations which the respondent brings to bear in support of her construction * * * are of course beside the point in this Court, since we must give the statute effect in accordance with the purpose so clearly manifested by Congress"). In ignoring the legislative history of the access-to-records statutes and rejecting the uniform understanding of those provisions by courts and commentators, the Second Circuit's decision impedes GAO's statutory responsibilities and defeats the intention of Congress.

C. GAO's Interpretation Of The Access-To-Records Provisions Is A Consistent And Longstanding Construction That Congress Has Recognized And Never Disapproved

From the time of their enactment in 1951, the access-to-records statutes consistently have been construed by GAO to authorize the examination of all cost records relating to the reasonableness of the contract price, and Congress, although aware of this construction, has not disapproved the agency's inter-

pretation or amended the statutes to reject that position. See J.A. 99.

Shortly after passage of the access-to-records provisions, the Comptroller General stated in a public decision that the statutes "were intended, among other things, to afford a means whereby the Congress could be informed of any excessive or unreasonable payments to contractors holding negotiated contracts * * *." 32 Comp. Gen. 277, 278 (1952). More than a decade later, the Comptroller General expressed the same view that "the overall objective [of an audit] is to review the manner in which the contracted activities of Federal agencies are administered and to recommend, where appropriate, corrective or improvement actions deemed necessary or desirable to promote greater efficiency or economy in Federal expenditures. * * * The audit reports of the General Accounting Office are intended * * * to inform the Congress and/or the Federal agencies concerned on the results of audit work on procurement contracts * * * and to make recommendations, based on such work, leading to greater efficiency and economy in such expenditures." United States General Accounting Office, *Audits of Government Contracts* 8-9, 16 (1966); see also *id.* at 19-20.

GAO's construction of the access-to-records statutes also has been repeatedly presented to Congress, which has never indicated its disapproval of the agency's view. For example, in the 1956 Annual Report to Congress under 31 U.S.C. 53(a), the Comptroller General explained that GAO "audits are designed to evaluate the manner in which agency representatives perform their respective functions relating to negotiated contracts, and include a review of the contractor's organization, procedures, and business methods for the purpose of evaluating the protection which

has been afforded the Government's interests." *Annual Report of the Comptroller General of the United States for the Fiscal Year Ending June 30, 1956*, at 23 (1956). See also G. Cuneo, *supra*, 184 & n.10.

In 1963, Robert Keller, General Counsel of GAO, appeared before a congressional subcommittee that was "concerned with the availability of cost data in negotiated contracts" and "the need for, or desirability of, recommending legislative action" in light of Hewlett-Packard's recent refusal to permit inspection of its cost records pursuant to the access-to-records provisions. See *Hearings on Relation of Cost Data to Military Procurement Before the Subcomm. for Special Investigations of the House Comm. on Armed Services*, 88th Cong., 1st Sess. 2, 3 (1963). Focusing on "the relationship of cost data to procurement and to post-audit review * * * [and on GAO's function] to make recommendations looking to greater economy and efficiency in public expenditures" (*id.* at 5), Mr. Keller testified that "[o]ur experience indicates the need for careful examination into the reasonableness of accepting catalog or other established prices for negotiated procurements, particularly where contractors have resisted requests by the procurement agencies for cost data to support price proposals and quotations" (*id.* at 8).[13] Emphasizing the impor-

[13] See also *Eli Lilly & Co.* v. *Staats*, *supra*, 574 F.2d at 915 ("[the] argument that Congress could not have intended to inquire into wastefulness in contracts such as the one here in which the drugs were supplied to the Government 'at a fixed price at or below the wholesale market price' * * * ignores the fact that the information sought by the Government may show that the prices it paid were nevertheless much too high"); *Hearings on Relation of Cost Data to Military Procurement*, *supra*, at 6-8 (statement of GAO General Counsel Keller) (citation omitted).

tance of "obtain[ing] reasonable assurance that the prices [the Government] contracted to pay were fair to the Government as well as to the supplier" (*id.* at 12) and of "evaluating the reasonableness of the prices quoted" (*id.* at 15), Mr. Keller explained GAO's construction of the access-to-records provisions (*id.* at 6, 10-11, 15; emphasis added):

> With the increased use of negotiated contracts for the purchase of supplies and equipment, the Congress, in order to assure that such supplies and equipment are obtained at reasonable prices, has provided that negotiated contracts shall include a clause giving the Comptroller General * * * the right to examine any pertinent books and records of the contractor * * * involving transactions related to * * * work under the contract.
>
> * * * * *
>
> It is our position that the contract clause and the statute give us the right to examine the cost records of the contractor and other pertinent data that relates to the items included in the contract, *in sufficient completeness and detail to permit us to determine the reasonableness of the negotiated prices.*
>
> We believe our position is supported by the language of 10 U.S.C. 2313(b) and the contract provision and, to an even greater extent, by the legislative history of the statute * * *.
>
> We believe, further, that our position is supported by the fact that our interpretation of the statute has been consistently applied since its enactment without objection by the Congress and, therefore, should be given the consideration normally accorded longstanding administrative interpretations of statutes.
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> * * * * *

> [I]f Hewlett-Packard is successful in preventing the General Accounting Office from obtaining access to its records relating to such negotiated contracts, the Government will be deprived of the most important means for examining into the reasonableness of contract prices.

And, with particular pertinence to the present case, Mr. Keller stated that GAO could "go beyond direct manufacturing costs" into such areas as "how research costs are allocated as between the Government contract and commercial business" (*id.* at 23). Representative Hardy, based on his "background of personal knowledge * * * [of] what congressional intent was at the time * * * [the statutes were] originally passed" (*id.* at 3), commented that Mr. Keller had "stated this case very well as to the necessity for having a contract provision permitting audits of negotiated contracts" (*id.* at 23).

Two years later, GAO again apprised Congress of its construction of the access-to-records provisions. Comptroller General Campbell testified that these provisions "permit detailed examination of a contractor's records to insure the necessary degree of supervision and control. In other words, the clear intent of the statute is to provide for the examination by the General Accounting Office of such records of a contractor, to such an extent as will permit a meaningful examination of the reasonableness of the prices charged to the Government." *Hearings on Comptroller General Reports to Congress on Audits of Defense Contracts Before the Subcomm. on Military Operations of the House Comm. on Government Operations*, 89th Cong., 1st Sess. 44 (1965). Mr. Campbell later reiterated GAO's position "that the contract clause and the statute on which the clause is based gives us the right to examine the cost records of the

contractor and other pertinent data that relate to the items included in the contract, in sufficient completeness and detail to permit us to examine into the reasonableness of the negotiated prices. * * * The fact that, in [the] final analysis, we may not be able to question the legality of particular contract transactions does not preclude our reporting to the Congress and to the responsible administrative agencies that such transactions are wasteful or extravagant or that a particular contract transaction illustrates the need for an improvement in existing procurement or management procedures" (*id.* at 45, 48).[14] And General Counsel Keller also stated the agency's view "that the Congress intended the General Accounting Office to examine the books and records of the contractor to make certain that the Government was getting a fair deal out of negotiated contracts" (*id.* at 147). See also *ibid.* (statement of Comptroller General Campbell) (if the contractor "had his records commingled * * * [GAO] would have to see everything," including records not otherwise covered by the access-to-records provisions).

In 1971, Congress was again advised of GAO's interpretation of the access-to-records provisions. Paul Shnitzer, Assistant General Counsel of GAO, testified that such access "is very good for the purpose of determining what costs the contractor actu-

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[14] Comptroller General Campbell's statement was clearly understood by Mr. Charles I. Derr, Senior Vice President, Machinery & Allied Products Institute, who described GAO's position to be "that the statute should be construed as broadly as is necessary in order to permit [GAO] to determine whether contract prices are reasonable." *Hearings on Comptroller General Audits, supra,* at 513; see also *id.* at 503 (statement of William J. Healey, staff counsel to the Machinery & Allied Products Institute).

ally incurred in the performance of the contract as compared to the contract price." *Hearings on Competitive Problems in the Drug Industry Before the Subcomm. on Monopoly of the Senate Select Comm. on Small Business*, 92d Cong., 1st Sess. 8018 (1971). Mr. Shnitzer then elaborated (*id.* at 8018-8019):

> What I am saying is, and we do have a case which ultimately went up as far as the Supreme Court, is that under our 1951 authority, the contract is required to include a provision which gives the GAO the right to examine records of costs, direct and indirect, generated in the performance of that contract. So if a contract is awarded to company A and it comes within the purview of this—it is a negotiated contract for, let us assume, $100,000—we would have a right then to go back and examine the records of company A—the cost records, direct and indirect, to determine how much it cost him to perform that contract * * *.

In light of this history, the court of appeals was plainly unwarranted in rejecting GAO's interpretation of the access-to-records provisions. See *Eli Lilly & Co.* v. *Staats*, *supra*, 574 F.2d at 915. The court failed to heed the " 'venerable principle that the construction of a statute by those charged with its execution should be followed unless there are compelling indications that it is wrong * * *.' " *E. I. du Pont de Nemours & Co.* v. *Collins*, 432 U.S. 46, 54-55 (1977), quoting *Red Lion Broadcasting Co.* v. *FCC*, 395 U.S. 367, 381 (1969). " 'To sustain * * * [GAO's] application of this statutory term, we need not find that its construction is the only reasonable one, or even that it is the result we would have reached had the question arisen in the first instance in judicial proceedings.' " *Udall* v. *Tallman*, 380 U.S.

1, 16 (1965), quoting *Unemployment Comm'n* v. *Aragon*, 329 U.S. 143, 153 (1946). Rather, "[i]t is settled that courts should give great weight to any reasonable construction of a regulatory statute adopted by the agency charged with the enforcement of that statute." *Investment Company Institute* v. *Camp*, 401 U.S. 617, 626-627 (1971). And this principle is particularly apt where, as in this case, there is a "longstanding and consistent administrative interpretation" (*Zenith Radio Corp.* v. *United States*, 437 U.S. 443, 450 (1978)) that " 'involves a contemporaneous construction of [the] statute by the [persons] charged with the responsibility of setting its machinery in motion' " (*Andrus* v. *Shell Oil Co.*, No. 78-1815 (June 2, 1980), slip op. 10, quoting *Norwegian Nitrogen Co.* v. *United States*, 288 U.S. 294, 315 (1933)).

Moreover, judicial deference to the agency's interpretation of a statute is especially appropriate " 'when Congress has refused to alter the administrative construction' * * * [and] that construction accords with well-established congressional goals." *Board of Governors of the Federal Reserve System* v. *First Lincolnwood Corp.*, 439 U.S. 234, 248, 251 (1978), quoting *Red Lion Broadcasting Co.* v. *FCC*, *supra*, 395 U.S. at 381. "[O]nce an agency's statutory construction has been 'fully brought to the attention of the public and the Congress,' and the latter has not sought to alter that interpretation * * *, then presumably the legislative intent has been correctly discerned." *United States* v. *Rutherford*, 442 U.S. 544, 554 n.10 (1979), quoting *Apex Hosiery Co.* v. *Leader*, 310 U.S. 469, 489 (1940). Here, "[i]n the * * * years during which [GAO] has consistently * * * [adhered to its position], Congress has never expressed its disapproval, and its silence in this regard

suggests its consent to [GAO's] practice." *EEOC* v. *Associated Dry Goods Corp.*, No. 79-1068 (Jan. 26, 1981), slip op. 9-10 n.17.

In these circumstances, GAO's interpretation of the access-to-records statutes should be followed.

D. The Access-To-Records Provisions Authorize The Comptroller General To Examine Respondent's Records Pertaining To Its Costs Of Research And Development, Advertising And Promotion, Distribution, And Administration

In light of the legislative history and administrative interpretation of 10 U.S.C. 2313(b) and 41 U.S.C. 254(c), the access-to-records provisions should be construed to authorize the Comptroller General to examine all of a contractor's cost records that are necessary and appropriate to determine whether the price charged the government was "extravagan[t]" "excessive," or "wasteful[]." 97 Cong. Rec. 13198 (1951) (remarks of Rep. Hardy). Any lesser right of access would seriously impair the Comptroller General's statutory responsibility to determine the reasonableness of the contract price and the adequacy of the protection afforded the government in negotiated procurements. Applying this standard to the present case, it is clear that the Comptroller General is entitled to access to respondent's cost records pertaining to research and development, advertising and promotion, distribution, and administration.

As the Seventh Circuit recognized in *Eli Lilly & Co.* v. *Staats*, *supra*, "it is hard to imagine anything more directly related to a contract than the cost of producing the items covered by it or the matters going into the makeup of the price" (574 F.2d at 913). See also *Hewlett-Packard Co.* v. *United States*, *supra*, 385 F.2d at 1016. The court of appeals in

Eli Lilly found that the records requested by GAO came well within the terms of the access-to-records provisions (574 F.2d at 914; footnote omitted):

> In response to plaintiff's argument that including these items would not give full effect to the limits on disclosure implied by the use of the word "directly," without disputing that "directness" is a difficult concept to define, it should be noted that costs such as research and development at the least appear to have a logical, causal and consequential relationship to a portion of the price of the products purchased by the Government. Further, contrary to plaintiff's contention, such costs are not "remote" within the established definitions of that term in relation to at least a portion of the price because their inclusion in the price of the product is not unforeseeable once the costs are incurred, nor is their impact on a part of the price significantly altered by any intervening cause.

This analysis accords with the purpose of the access-to-records statutes to determine whether the government "c[a]me out on the short end of the deal" (97 Cong. Rec. 13198 (1951) (remarks of Rep. Hardy)) and with GAO's construction of the access provisions to allow an "examin[ation of] the cost records of the contractor * * * in sufficient completeness and detail to permit us to examine into the reasonableness of the negotiated prices" (*Hearings on Comptroller General Audits*, *supra*, at 45 (statement of Comptroller General Campbell)).[15]

Indeed, the records sought in this case are particularly important in the context of pharmaceutical contracts. The manufacturing and distribution costs

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[15] See also Comment, *supra*, 92 Harv. L. Rev. at 1157-1158 & nn.67-68.

of individual pharmaceutical products have been estimated to constitute as little as 9% of the sale price of such products. See *Eli Lilly & Co.* v. *Staats, supra,* 574 F.2d at 913, citing Rucker, *Public Policy Considerations and the Pricing of Prescription Drugs in the United States,* 4 Int'l J. Health Services 171, 173 (1974).[16] See also *SmithKline Corp.* v. *Staats, supra,* 483 F. Supp. at 722. At the same time, "the drug industry devotes a 'significant portion' of its sales revenues (11.9 percent of the industry's 1971 sales) to research of new and improved ethical drugs and biological products" (J.A. 96). See also Reekie, *Price and Quality Competition in the United States Drug Industry,* 26 J. Indus. Econ. 223, 235 (1978) ("innovative outlays [are] by far the largest forms of outlay in the drug industry; manufacturing and other short-run variable costs form only a small proportion of total costs"). To confine access by the Comptroller General to records of the relatively minor direct costs (such as manufacture and delivery), and to exclude records of virtually all other costs (such as research and development) that are more substantial than the direct costs, would plainly frustrate GAO's responsibility to examine the contractor's cost

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[16] Mr. Rucker states (*ibid.*):

> The first major issue deals with the proportion of product price that is accounted for by direct manufacturing and distribution costs. Table 1, which presents data for nine important branded products marketed in the U.S.[,] shows a median of 91 per cent as the proportion of supplier's revenue consumed by indirect factors, such as research and development, promotion, general administrative expense, taxes, and profit. Thus we see that only a very small percentage of wholesale price represents the direct expense of making the pharmaceutical agent available for patient consumption.

records in order to assess the fairness of the contract price.

Nevertheless, the court below concluded that such a limitation was required in this case because the records in question involve costs that respondent neither allocates to particular products or contracts nor calculates on a product basis in setting prices.[17] This analysis, which fails even to mention GAO's legitimate need for access to the requested records, is misconceived. First, the government cannot be bound by the accounting method respondent has established for its own purposes. Cf. *Exxon Corp.* v. *Department of Revenue of Wisconsin*, No. 79-509 (June 10, 1980), slip op. 12-14. If respondent had fully allocated its costs, GAO's right to conduct an inspection adequate to evaluate the reasonableness of the contract price would be clear. No different outcome is warranted simply because respondent has chosen to allocate only some of its costs to particular contracts or products. Indeed, the logical consequence of the court of appeals' decision is that respondent would not be obliged to open any of its books to the Comptroller General if, for internal bookkeeping purposes, it chose to allocate none of its costs to a particular contract or product.[18]

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[17] It does appear, however, that respondent, by setting its prices in part on the basis of its historical pricing and that of its competitors, takes into account its unallocated costs (J.A. 120, 133, 137-138).

[18] The courts below purported (Pet. App. 12a) to "agree with the government that the issue [of access] should not depend entirely on a contractor's bookkeeping method, *i.e.*, whether it does or does not assign particular costs to particular contracts or products." In the end, however, GAO was not afforded access to any records of costs that respondent does not in fact assign. See J.A. 120-129.

Moreover, respondent's election to keep its business records on the basis of unallocated costs cannot obscure the fact that an examination of these costs is necessary for the Comptroller General to discharge his statutory responsibility to determine whether the government has been charged a reasonable price. To operate profitably, respondent must recover its costs from sales revenues, and it uses the payments by the government under the contracts at issue, as part of commingled general revenues, to help defray its unallocated expenses (J.A. 96, 103, 106, 137-140).[19] Accordingly, respondent's costs, even though unallocated, are critical to an assessment of the fairness of the contract price and the advisability of continued adherence by the government to the negotiated procurement methods employed here. If respondent's total costs are substantially lower than the prices paid by the government, the Comptroller General may recommend that the Department of Defense and the Veterans Administration adopt different procurement practices in the future. See *Hewlett-Packard Co.* v. *United States*, *supra*, 385 F.2d at 1016 ("[w]hile this appraisal could not affect these particular contracts, it could lead to use of other methods of meeting future procurement needs").

Nothing in the language of the statutes or their legislative history justifies the restriction imposed by the court of appeals on the applicability of the access provisions to respondent's unallocated costs. On the contrary, the court's construction would effectively defeat the congressional objective to guard against waste, extravagance, and excessive pricing. And, as explained in *Eli Lilly & Co.* v. *Staats*, *supra*, "[t]he mere fact that, as [respondent] asserts, it does not

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[19] The government was charged respondent's normal wholesale price (J.A. 133, 136).

or even could not allocate costs such as research and development to an individual contract does not undercut the proposition that those costs are directly pertinent to an individual contract but merely indicates that they are directly pertinent to more than one individual contract" (574 F.2d at 914). Especially in light of the cost structure in the pharmaceutical industry (see pages 31-32, *supra*), it is manifest that the Comptroller General's inquiry into the appropriateness of the contract price cannot be limited to allocated costs of production and delivery and must include such significant unallocated costs as research and development, advertising and promotion, distribution, and administration. Respondent's contrary position would plainly thwart the congressional policy and would reduce the Comptroller General's exercise of his remedial authority to an empty and ineffectual endeavor.[20]

The question of cost allocation is a familiar one in the area of government contracts. For example, 41 C.F.R. 1-3.1220(b)(4), which is applicable to negotiated procurements (see 41 C.F.R. 1-3.000, 1-3.100), defines "allocate" to "include[] both direct assign-

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[20] Of course, insofar as respondent has allocated a given category of costs, the Comptroller General would be entitled to examine records relating only to such costs as have been attributed to the product supplied the government (together with records necessary to verify such data). To the extent that broader access is required in this case, it is the result of respondent's decision not to allocate its costs and the consequent need for the Comptroller General to construct a measure of those costs in order to determine the reasonableness of the contract price. Whatever the nature of a contractor's accounting system, the Comptroller General's authority remains the same—to examine those costs necessary to determine whether the contract price was "extravagan[t]," "excessive," or "wasteful[]." 97 Cong. Rec. 13198 (1951) (remarks of Rep. Hardy).

ment of cost and the reassignment of a share from an indirect cost pool." See also 41 C.F.R. 1-3.1220(b)(14) and (15), 1-15.202, 1-15.203 (definitions of "indirect cost" and "indirect cost pool"). In addition, 41 C.F.R. 1-15.201-4 provides that

> a cost is allocable to a Government contract if it:
>
> (a) Is incurred specifically for the contract;
>
> (b) Benefits both the contract and other work, or both Government work and other work, and can be distributed to them in reasonable proportion to the benefits received; or
>
> (c) Is necessary to the overall operation of the business, although a direct relationship to any particular cost objective cannot be shown.

And, with particular reference to research and development, 41 C.F.R. 1-15.205-35 sets forth the applicable principles to calculate the portion of such costs attributable to a government contract. If the contracts in this case were cost-based rather than fixed-price, respondent would be entitled to claim reimbursement for its indirect costs that were allocable to those contracts. There is no reason to conclude that the same approach is inapplicable where, as here, it is GAO that seeks to make the allocation in order to review the adequacy of the protection afforded the government's interest in negotiated procurement.[21]

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[21] We note that in those access-to-records cases in which the government has prevailed, there was apparently no difficulty in fashioning suitable relief. (For the convenience of the Court, we have appended a copy of the unpublished order of the district court on remand in *Eli Lilly & Co.* v. *Staats*, *supra*. See Appendix, *infra*, 1a-5a.) Courts have solved similar problems, involving inspection of records showing a company's profit or loss on particular product lines, in the context of

Finally, the court of appeals incorrectly relied on the presumed intentions of the parties to hold that the contractual access-to-records clause does not encompass the materials sought by the Comptroller General concerning respondent's unallocated costs. In view of the decision in *Hewlett-Packard*, GAO's public statements of its construction of the access provisions (see pages 23-28, *supra*), and the general recognition of GAO's position (see page 21, *supra*), respondent was on notice of GAO's interpretation and cannot be assumed to have had a contrary understanding. See *Eli Lilly & Co.* v. *Staats*, *supra*, 574 F.2d at 918.[22] But, more important, the meaning of the contractual access-to-records clause does not rest on the understanding of the parties. The clause was statutorily required to be included in the contract, and its content is necessarily determined by those statutes rather than by the parties' intentions. See, *e.g.*, *Federal Crop Insurance Corp.* v. *Merrill*, 332 U.S. 380, 383-385 (1947); *De Matteo Const. Co.* v. *United States*, 600 F.2d 1384, 1391 (Ct. Cl. 1979); *Jackson* v. *United States*, 573 F.2d 1189, 1194 (Ct. Cl. 1978); *G. L. Christian and Associates* v. *United States*, 320 F.2d 345, 351 (Ct. Cl.), cert. denied, 375 U.S. 954 (1963); cf. *United States* v. *Wunderlich*, 342 U.S. 98, 100 (1951).

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discovery under the Federal Rules of Civil Procedure. See, *e.g.*, *United States* v. *International Business Machines Corp.*, 66 F.R.D. 186 (S.D.N.Y. 1974).

[22] See also, *e.g.*, *Stencel Aero Engineering Corp.* v. *United States*, 431 U.S. 666, 674 n.8 (1977); *Bowers Dredging Co.* v. *United States*, 211 U.S. 176, 188 (1908); *Jamesbury Corp.* v. *Worcester Valve Co.*, 443 F.2d 205, 210 n.7 (1st Cir. 1971); *Perry and Wallis, Inc.* v. *United States*, 427 F.2d 722, 725 (Ct. Cl. 1970); I *Chitty on Contracts* ¶ 613, at 288 (23d ed. 1968); 3 A. Corbin, *Contracts* § 537, at 45, § 556, at 243 (1960).

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

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FEBRUARY 1981

APPENDIX

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF INDIANA
INDIANAPOLIS DIVISION

No. IP 75-72-C

ELI LILLY AND COMPANY

v.

ELMER B. STAATS,

COMPTROLLER GENERAL OF THE UNITED STATES,
DEFENDANT,

UNITED STATES OF AMERICA, INTERVENOR

JUDGMENT

This matter comes to the Court upon remand from the U.S. Court of Appeals for the Seventh Circuit for proceedings consistent with its opinion herein. In accordance with the Mandate of the U.S. Court of Appeals for the Seventh Circuit this Court does now vacate its judgment of November 30, 1976. The parties, to avoid further litigation and to resolve their differences, agree and consent to the terms of this judgment. Therefore, the Court, being duly advised in the premises, ORDERS this 28th day of November 1978, that:

1. The Motion for Summary Judgment filed on behalf of the United States of America, defendant-intervenor, on its counterclaim against the plaintiff, Lilly, be and the same hereby is, granted as reflected in this order, and Lilly's Cross Motion is denied.

2. The Comptroller General of the United States and his duly authorized representatives have the right to examine all books, documents, papers, or records directly relating to the pricing and cost of producing items furnished by plaintiff, Lilly, under the following contracts numbered: V797P-5169(C), DSA120-74-C-1401, DSA120-74-C-0125, DSA120-74-C-1639, DSA120-74-C-0896, DSA120-74-C-1176 and DSA120-74-C-1640, including, but not limited to, records of experienced costs, including costs of direct materials, labor, overhead, and other corporate costs, records in support of prices charged to the Government and such other necessary information which would permit representatives of the Comptroller General of the United States to review the reasonableness of the contract prices provided for in the aforesaid contracts, except that no access is granted to any additional documents, and no information need be produced relating to classes of costs that have no more than a *de minimis* impact on the price of a product purchased by the Government.

3. The plaintiff, Lilly, its officers, agents, servants, attorneys, employees and all persons in active concert or participation with them who receive actual notice of an order by personal service or otherwise, are enjoined from preventing the duly authorized representatives of the Comptroller General of the United States from exercising the right to examine granted hereby and plaintiff Lilly, including its officers and subordinates, are directed to have available on the premises of Lilly, Indianapolis, Indiana, and its other principal offices wherever located, such books and records at a time and date to be fixed by the Court upon application of the Comptroller General of the United States or his duly authorized representatives.

4. The original and all copies of every book, report, paper, record, and other document (all hereinafter referred to as "document"), designated as confidential by Lilly or any of its divisions or subsidiaries and provided or otherwise made available to the Comptroller General or any of his successors, agents, employees, or subordinates (all hereinafter referred to as "the Comptroller General"), and every summary thereof and extract therefrom, and all data and information contained therein, including accountants' workpapers (all hereinafter referred to as "data"), shall be held in confidence and shall not be provided or otherwise made available by the Comptroller General to any other person or agency except as provided in subparagraphs (a) and (b) below. No copies of Lilly's documents shall be included in accountants' workpapers without the approval of Lilly.

5. Any document and data referred to in the above paragraph shall be used by the Comptroller General solely for the purpose of a contract study and no information other than that pertaining to Lilly's government business shall appear in any report by the Comptroller General or otherwise be made public. Upon completion of that study, the Comptroller General shall immediately return to Lilly the originals and all copies of all documents described in that paragraph. Any data in which Lilly, any of its divisions or subsidiaries, or any product manufactured or sold by any of them are or may be directly or indirectly identified which the Comptroller General deems it necessary to retain shall be deposited with and maintained by the Comptroller General under security measures to be agreed upon by the parties. Any such data which the Comptroller General does not deem it necessary to retain shall be destroyed immediately upon the completion of the study. Access to such data

by any person shall be permitted only upon written authorization of the Comptroller General and only when permitted under the subparagraphs following next denominated (a) and (b).

(a) Any of the data referred to in the above paragraphs may be published, provided to, or otherwise made available to a person or agency other than the Comptroller General if the data are published, provided, or made available in such a way that any direct or indirect identification of Lilly, any of its divisions or subsidiaries, or any product manufactured or sold by any of them, is not reasonably possible. Lilly shall be afforded a reasonable opportunity to examine and offer its comments regarding any data considered for release, including any report issued by the Comptroller General that includes such data, before release of the data or report.

(b) The Comptroller General may comply without regard to the limitations of this Order set forth in subparagraph (a) above, with an official written request for any of the data referred to above submitted to him by either House of Congress, or any committee of the House of Representatives or the Senate, or any joint committee of the two Houses, having jurisdiction over the subject matter of said study, to the extent authorized and directed by law. The Comptroller General will cause prompt notice of any such request to be given to Lilly and to this Court at least seven calendar days prior to furnishing the data requested.

6. The Comptroller General and the United States shall notify Lilly promptly of any request for disclosure, subpoena *duces tecum*, civil action, or other

order or application for an order seeking production, release, or disclosure of any documents or data referred to above, and further agree to use their best efforts to protect the confidentiality of such documents or data, except as provided in subparagraph (a) above, including resort to appropriate judicial remedies and cooperation with Lilly in such efforts.

7. The Court shall retain jurisdiction to interpret and enforce the terms of this Consent Judgment, upon application of any party.

8. The costs of this action shall be taxed against plaintiff, Lilly.

CALE J. HOLDER
United States District Judge

Done at Evansville, Ind.
this 28 day of Nov., 1978.

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